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Supreme Court of the United States

OCTOBER TERM—1942

No. 542

ADDISON S. PRATT, as Trustee of JACELLEN REALTY CORPORATION, Debtor,
Petitioner, (Plaintiff below),

against

CHEMICAL BANK & TRUST COMPANY and THE CONTINENTAL BANK AND TRUST COMPANY OF NEW YORK,
Respondents, (Defendants below).

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

ADDISON S. PRATT,
Petitioner in person,
21 West Street,
New York City,

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CHEMICAL BANK & TRUST COMPANY and THE CONTINENTAL BANK AND TRUST COMPANY OF NEW YORK,
Respondents, (Defendants below).

No.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

TO THE SUPREME COURT OF THE UNITED STATES:

Addison S. Pratt, as Trustee of Jacellen Realty Corporation, Debtor, respectfully prays this Honorable Court for the issuance of a Writ of Certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit in the above entitled action.

Jurisdiction

The jurisdiction of this Court is based on §240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

The judgment of the Circuit Court of Appeals, sought to be reviewed, was entered on August 19, 1942.

This petition was filed on November 24, 1942, the time to file the same having been extended, by order of Mr. Justice Jackson, to that date.

Opinions Below

The opinion of the Circuit Court of Appeals is reported in 129 Fed. (2d) 1016. The opinion of the District Court has not been officially reported.

Statement of Matters Involved

The action was brought by the Trustee of the Debtor, appointed in proceedings for its reorganization under §77B of the Bankruptcy Act, to recover from the defendants, Chemical Bank & Trust Company and The Continental Bank and Trust Company of New York, the sums of $17,332.26 and $27,327.41, respectively, as constituting transfers, admittedly made in payment of antecedent indebtedness, and alleged to be voidable by the Trustee under Section 70(e) of the Bankruptcy Act, on two grounds:—

(1) that they had been made at a time when the Debtor was insolvent, or its insolvency was imminent, and with the intent of giving the Banks a preference over other creditors, as they knew, or had reasonable cause to believe, in violation of the second sentence of Section 15 of the New York Stock Corporation Law, and (2) that they had been made at a time when the Debtor had refused to pay its obligations, when due, the Banks being stockholders of the Debtor, in violation of the first sentence of Section 15.

The sums so transferred were the balances in the deposit accounts of the Debtor with the Banks on October 19, 1937 when the Banks set off these balances against the Debtor's demand notes.

Third causes of action under Sections 60(a) and (b) of the Bankruptcy Act were also alleged but were abandoned on the trial.

The complaint, as to both causes of action against each Bank, was dismissed by the trial court and its judgment was affirmed, but on different grounds, by the Circuit Court of Appeals.

The evidence was neither contradicted nor contradictory. Decision depends upon the conclusions or inferences to be drawn from the evidence—questions of law. As to the first causes of action, the trial court held (R. 29-31) that it could not be inferred that insolvency of the Debtor was either actual or imminent or that there was an intent to prefer the Banks when the deposits in the accounts were made or on October 19, 1937. The Circuit Court of Appeals (R. 365-366) did not consider insolvency but held that there was no intent to prefer and that the transfers could be upheld as banker's liens entitled to setoff.

As to the second causes of action, the trial court held (R. 31-32) that the Debtor had not failed to pay its obligations, when due, but did not consider whether the Banks were stockholders. The Circuit Court of Appeals, on the other hand, held (R. 366) that the Banks were not stockholders but did not pass upon the other question.

Questions Presented

1. Under the circumstances here present, were the defendant Banks entitled to set off the balances in the Debtor's deposit accounts against the Debtor's demand notes, when such deposits had been made so that the Banks might seize them at any time and could be withdrawn by the Debtor only with the consent of a representative of the Banks, or did such deposits and such subsequent application of the balances constitute preferential transfers under the second sentence of §15 of the New York Stock Corporation Law, voidable under §70(e) of the Bankruptcy Act by the Debtor's trustee appointed under §77B of the Bankruptcy Act?

2. Did the application by the defendant Banks on account of the Debtor's demand notes of the balances in the

Debtor's deposit accounts, the Banks having required, as a condition of making the loans, that all the Debtor's capital stock be transferred to their nominees, and having refused to allow the Debtor to use the balances to pay the interest on its mortgage, constitute a transfer of the Debtor's property to its stockholders for the payment of a debt, prohibited by the first sentence of Section 15 of the New York Stock Corporation Law and voidable, under Section 70(e) of the Bankruptcy Act, by the Debtor's trustee?

The Statutes Involved

The first sentence of Section 15 of the New York Stock Corporation Law provides:

> "No corporation which shall have refused to pay any of its notes or other obligations, when due, in lawful money of the United States, nor any of its officers or directors, shall transfer any of its property to any of its officers, directors or stockholders, directly or indirectly, for the payment of any debt, or upon any other consideration than the full value of the property paid in cash.

The second sentence of Section 15 of the New York Stock Corporation Law provides:

> "No conveyance, assignment or transfer of any property of any such corporation by it or by any officer, director or stockholder thereof, nor any payment made, judgment suffered, lien created or security given by it or by any officer, director or stockholder when the corporation is insolvent or its insolvency is imminent, with the intent of giving a preference to any particular creditor over other creditors of the corporation, shall be valid, except as to any rights or interests which may be acquired thereunder by any person without notice or reasonable cause to believe that such conveyance, assignment, transfer, payment, judgment, lien or security would effect a preference. * * *

"Every person receiving by means of any such prohibited act or deed any property of a corporation shall be bound to account therefor to its creditors or stockholders or other trustees. * * * Every transfer or assignment or other act done in violation of the foregoing provisions of this section shall be void, except as hereinbefore provided."

Section 70(e) of the Bankruptcy Act provides:

"e. (1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor.

"(2) All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall be avoided by, the trustee for the benefit of the estate. The trustee shall reclaim and recover such property or collect its value from and avoid such transfer or obligation against whomsoever may hold or have received it, except a person as to whom the transfer or obligation specified in paragraph (1) of this subdivision e is valid under applicable Federal or State laws."

Specification of Errors

The Circuit Court of Appeals erred in

(1) dismissing the complaint,

(2) holding that the Debtor had no intent to prefer the Banks and that the Banks, in the exercise of their banker's liens, had the right to set off the balances in the Debtor's accounts, and

(3) holding that the Banks were not stockholders of the Debtor.

The District Court also erred in

(1) dismissing the complaint,

(2) holding that insolvency of the Debtor was neither actual nor imminent,

(3) holding that the Debtor did not intend to prefer the Banks, and

(4) holding that the Debtor had not failed to pay its obligations, when due.

Reasons for Issuance of Writ

The first question is one of general public interest and great importance in the administration of the Bankruptcy Act, for, if the decision of the Circuit Court of Appeals is sound, a way is approved whereby a bank may lend money to its depositor on the latter's demand note and, by demanding and obtaining absolute and complete control of its depositor through transfer to a nominee of all its capital stock, control of its board of directors and control over its operations by requiring that all its income be deposited with it and withdrawn only upon the counter-signature of its appointee on all checks, may, when the depositor has become insolvent, or its insolvency has become imminent, set off against the note the balance in the account in the exercise of its banker's lien, despite the fact that all the deposits had been made with the intention of creating a fund which the bank might apply in setoff whenever it might choose to do so.

Here, as a result of these setoffs, Chemical received about 93% of the Debtor's indebtedness to it and Continental about 46%, while the first mortgagee and the holders of the participation certificates issued thereunder received nothing at all on account of the interest which was due to them eighteen days before the setoffs. The Debtor was denuded of all its assets except its real estate, and was obliged to give an assignment of the rents to the mortgagee.

The decision below seems clearly erroneous and directly contrary to the qualifications upon the right of a bank to set off a balance in its depositor's account against the latter's note which this court stated in the case of *N. Y. County National Bank* v. *Massey*, 192 U. S. 138.

It was there held that the balance in a regular bank account at the time of adjudication is a debt due from the bank to the bankrupt and that, *in the absence of fraud or collusion between the bank and the bankrupt with the view of creating a preferential transfer*, the bank need not surrender the balance but may set it off against notes of the bankrupt held by it, on the theory that a deposit of money to one's credit in a bank does not operate to diminish the estate of the depositor, for, when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit whenever he may see fit to draw a check against it.

In the case at bar, the Circuit Court of Appeals held that the deposits in the Debtor's account had not been made for the purpose of giving a preference to the Banks, despite uncontradicted evidence that that was the original arrangement when the loans were first made in March, 1934, the reasoning leading to this conclusion being that such an intent could not be sustained through the vicissitudes of three years' business dealings, because the Debtor knew that its accounts might be debited at any moment, which was not the same as saying that the money was deposited so that it would be debited (R. 365). The court entirely overlooked the element of absolute control which the Banks had over the Debtor and which continued during the entire three year period. It is this fact and the fact of collusion or agreement between the Debtor and the Banks that all the Debtor's income—the rents from its property—should be deposited with them where it would be available for setoff whenever the Banks might desire, which brings this case within the exception in the *Massey* case. This justifies the issuance of a writ of certiorari to review the first question in order to prevent the course of action here from being followed as a precedent by other banks.

As to the second question, the decision of the Circuit Court of Appeals that the Banks were not stockholders of the Debtor but only creditors, holding the stock as security merely, seems clearly erroneous, for pledgees of stock held as collateral are deemed to be stockholders where the stock has been transferred into the pledgee's name. Whether they are to be treated as stockholders under §15 of the New York Stock Corporation Law has never been considered in any reported case, State or Federal. This question should be reviewed in connection with the first question, for it is so closely connected with the first question as to be collateral thereto.

The decision of the District Court (the question was referred to only in passing by the Circuit Court of Appeals) that the Debtor had not refused to pay its obligations, when due, also should be reviewed as part of this question. It, too, seems clearly erroneous, for the reason that it was based solely on the fact that the Debtor had never paid the interest on its mortgage punctually on the due date and the conclusion therefrom that the due date had thereby been extended—a conclusion incompatible with an express covenant of the mortgage.

For the reasons aforesaid the issuance of a Writ of Certiorari is sought.

Dated, November 23, 1942.

Respectfully Submitted,

ADDISON S. PRATT,
Petitioner in person,
21 West Street,
New York City.

I hereby certify, as a member of the bar of this Court, that the foregoing petition is, in my opinion, well founded and that it is not submitted for purposes of delay.

ADDISON S. PRATT,
Petitioner in Person.